

FINANCING SAUDI MINING AND ENERGY TRANSITION

THE PROJECTS MARKET IN THE KINGDOM OF SAUDI ARABIA CONTINUES TO EXCITE INVESTORS, DEVELOPERS, FINANCIERS AND OTHER MARKET PARTICIPANTS. THE BOLD PLANS SET OUT IN THE KINGDOM'S VISION 2030 PLAN WILL PRESENT OPPORTUNITIES ACROSS A BROAD VARIETY OF SECTORS AS SAUDI ARABIA LOOKS TO REFORM AND DIVERSIFY ITS ECONOMY AND INDUSTRIAL BASE. BY **NICK COLLINS**, PARTNER, LONDON, **ED HILLS**, SPECIAL COUNSEL, LONDON, **RAKAN ALYUSUF**, ASSOCIATE, RIYADH, AND **INAYA HOMOUD**, ASSOCIATE, LONDON, **BAKER BOTTS**.

Many of these opportunities are expected to arise out of the high profile mega-projects¹ and the oil and gas, petrochemicals and mining sectors, which the Vision 2030 plan identified as the Kingdom's three industrial pillars.

While it is well-known that the Kingdom has vast hydrocarbon reserves, the country also has significant mineral and metal resources that are relatively under-explored and under-developed. The Kingdom sits on an area of Precambrian rock formations known as the Arabian Shield, which the Saudi Geological Survey has identified as having reserves of nickel, copper, zinc, rare earth materials, uranium and gold.² Many of those minerals and metals are considered critical to the energy transition industries.

In recent years, there has been a strong focus by the Kingdom's leadership on diversifying from oil and gas and petrochemicals, including a focus on renewable energy, green fuels such as low carbon hydrogen/ammonia, and energy transition initiatives. Given its potential critical rare earth mineral and metal reserves, the Kingdom has a significant opportunity to develop a successful integrated mining and clean energy industry.

For the Kingdom to fully maximise its potential in the mining and energy transition industries it will require not only capital investment, but also investment in human capital and expertise, new technologies and the infrastructure required to support those industries.

The investment environment

The limited amount of prospecting and exploitation of the Kingdom's mineral resources can, in part, be attributed to a relative lack of investment in the mining and minerals sector in the Kingdom owing to a historical focus on the hydrocarbon and

petrochemical sectors and a regulatory regime in the mining and minerals sectors that was perceived to insufficiently incentivise private sector and foreign investment.

Since the publication of the Vision 2030 plan, the Kingdom's leadership is taking positive steps to reform the country's regulatory and investment climate in the mining and mineral sector in order to promote private sector and foreign investment.

In 2020, the Kingdom's leadership promulgated a New Mining Investment Law, the New Mining Law, which, among other things, is intended to provide a regulatory framework to encourage the rapid development of this sector in the Kingdom. Notably, the New Mining Law provides for:

- A streamlined process to obtain exploration and mining licences;
- The establishment of a national geological database;
- The establishment of a mining fund that will provide support by way of loans financed by fees, fines and other levies imposed by the Ministry of Industry and Mineral Resources;
- Various government financial incentives for prospective mining entities; and
- A framework for rights granted under an exploration or exploitation licence to be pledged as security to financiers.

These legislative reforms have, to a large extent, been driven by the National Industrial Development and Logistics Program (NIDLP), a cross-government delivery programme launched in 2019 aimed at transforming the Kingdom into a leading industrial powerhouse and a global logistics hub, by maximising the value of its mining and energy sectors.³

Headed by the Minister of Industry & Mineral Resources and with a board made up of representatives from other key ministries of the Kingdom, the NIDLP is expected to play a significant role in coordinating the Kingdom's economic and industrial development, including ensuring appropriate integration across the different national sector strategies.

The Kingdom's leadership hopes that these reforms, together with positive engagement between governmental authorities and the



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private sector in the Kingdom, will lead to increased mining prospecting, discovery and development of commercially viable mines. Recent press reports suggest that the total number of issued mining licences reached 2,069 by the end of May 2022.

In April, eight firms including Ma'aden, Ivanhoe Electric and Vedanta Ltd were reported to have been pre-qualified to bid for the largest mineral exploration licence at the Khnaigiuyah site, which is believed to have huge zinc and copper reserves. Further along the industrial chain, EV Metals Group plc (EVM) has announced plans to develop a complex in Yanbu Industrial City to produce battery chemicals for electric vehicles and renewable energy storage. Although the mineral feedstock for this project will initially come from Australia, EVM's stated goal is to ultimately source minerals from mines in the Kingdom.⁴

With an enhanced framework to invest in projects in the minerals and mining and energy transitions sectors in the Kingdom, it is likely that a number of projects will seek to be financed using the project finance model, especially as the Kingdom has a strong record of developing and project financing projects across a broad variety of industry sectors, including many projects sponsored by national champions such as Saudi Aramco, SABIC, Ma'aden and Saudi Electric Company. In the mining and metals sector, Ma'aden has successfully project-financed bauxite, alumina, aluminium smelter and phosphates projects.

Project bankability and key risks

To attract project financing, projects in the minerals and mining and clean-energy industry sectors, the Kingdom will need to be economically viable and structured in a manner to ensure that key risks are identified, mitigated and/or allocated appropriately and are therefore bankable. Key areas of risk that would typically need to be analysed include those associated with reserves, construction, market, infrastructure, technology, environmental and social matters and, potentially, project-on-project risks.

It is very likely that the project financing structures and risk allocation models adopted by Ma'aden on its project financings as well as those used in projects in the petrochemicals, oil and gas and power sectors and the more recent pioneering projects in the renewables and green hydrogen sectors will be a relevant starting framework to determine risk allocation on projects in the Kingdom's minerals and mining and energy transition industry sectors.

Set out below are further details on some of the key risks that need to be considered:

- *Reserves risks* – A key component of the financial viability of any mining project is the quantum and quality of the reserves at the mine. Financiers will expect extensive studies

and reserves estimates to have been carried out and reported on by independent experts.

- *Construction risks* – Ensuring that a project is constructed on time and within budget is a key bankability factor. As such, lenders will closely analyse the capability of the chosen contractor(s) to deliver the project and the appropriateness of the chosen contracting strategy, eg LSTK, EPCM, EPC consortia, PMC etc. These decisions will impact the price of the project and determine the nature and extent of the sponsor support arrangements that may be required during the construction phase.

- *Market risks* – With green energy initiatives in the Kingdom, such as those contemplated at NEOM, the potential to sell products derived from critical and rare earth materials to the Kingdom's domestic market is considerable. Furthermore, the geographical location of the Kingdom offers enviable proximity to key international export markets in Europe, North America, Asia and Africa.

Despite the positive outlook for critical and rare earth minerals in the domestic and international markets, the relative nascency of these markets creates some additional risk that needs to be taken into account as the technologies and the markets themselves develop. Until the markets are sufficiently developed, it is unlikely that financiers will be prepared to take market risk and our expectation is that lenders will be likely to require that robust, long-term offtake agreements are in place and/or require appropriate government support to be provided to a project.

Over the years, Saudi state-owned contracting entities have made commitments with respect to numerous projects and have participated as the offtaker across a broad variety of industry sectors, eg the renewables, power and petrochemicals sectors. It is likely that similar approaches will be adopted in the mining and energy transition sectors, particularly where a project aligns with a key policy objective of the Kingdom's leadership.

In this context, the electrical vehicle manufacturer, Lucid Group Inc, in which the Kingdom's sovereign wealth fund, the Public Investment Fund (PIF), owns a majority stake, is establishing a manufacturing facility in the Kingdom and has signed agreements that will provide financing and incentives to Lucid of up to US\$3.4bn over the next 15 years. An important component of these arrangements is that the Kingdom's government has committed to purchase up to 100,000 electric vehicles from Lucid over a 10-year period.

- *Infrastructure risks* – An existing constraint on the attractiveness of future mining projects is the relatively remote location of the Arabian Shield area, which is some distance from the major urban areas of Riyadh, Jeddah and the Red Sea coast. Mining projects require supporting utilities and logistics infrastructure;

in particular, water facilities for mineral treatment, power generation facilities and road, and, in certain cases, rail, access to transport materials and equipment to develop and construct the mine and then to transport product(s) to market. The required utilities and logistics infrastructure will be likely to require considerable investment by the relevant developer and/or support and/or investment from the Kingdom's government.

Fortunately, NIDLP's Delivery Plan acknowledges these challenges and provides that NIDLP will play a key role in empowering the infrastructure, developing competencies, and providing funding support for the development of the required infrastructure. The Delivery Plan also notes that an overarching goal of NIDLP will be to link the mining regions with industrial and economic cities (such as NEOM and KAEC) and the Kingdom's ports and other cities. The expectation is that projects that are economically feasible will be eligible to receive appropriate financial support and incentives under NIDLP programmes.⁵

- *Technology risks* – The technology utilised in a project will be closely examined by financiers to ensure it is reliable and will operate at expected performance levels to ensure the project will be able to generate sufficient revenues to repay its loans. The potential combination of innovative, but not yet fully tested, technologies and a developing industry is likely to necessitate enhanced lender due diligence and a requirement for robust performance warranties from relevant technology and equipment providers.
- *Environmental and social risks* – Environmental and social matters are key concerns for both project developers and project financiers, and extensive environmental and social impact studies will need to be undertaken before a project proceeds. Furthermore, extensive due diligence of the in-country environmental legal regime will be required and projects will be required to comply with applicable local laws and regulations as well as applicable international standards such as the Equator Principles and the Mining Principles drawn up by the International Council on Mining & Metals (ICMM).
- *Project-on-project risks* – Project sponsors will need to carefully manage project-on-project risks, both upstream and downstream of their projects, including aligning key contractual provisions throughout the value chain, such as project start-up delays, remedies for non-

performance and default, and force majeure, etc. and by allocating appropriate risks to project counterparties. Managing project-on-project risks is, of course, by no means unique to mining projects, but these risks can be amplified when innovative technologies are employed across multiple stages of a value chain, and particularly so in an emerging industry.

Sources of financing

The level of financial investment required to drive forward the Kingdom's mining and minerals sector is considerable, with recent press reports suggesting that the Ministry of Industry & Mineral Resources wants to attract investment in the region of US\$170bn in the mining sector by 2030. There will be many projects competing for financing but if a project is commercially viable and well-structured, there should be a good likelihood of its sponsors raising the level of equity and debt financing required.

The Kingdom's state-owned entities have an excellent track record as project sponsors and partners to international investors in project financings in the Kingdom and via these entities it has the mechanisms and ability to commit high levels of investment towards projects and industries of national significance. Blue-chip international sponsors and developers have invested in many projects in the Kingdom and the Kingdom's leadership is actively engaging with the international mining and energy transition communities to encourage private investors and international developers, and to facilitate their entry into mining and minerals and energy transition sectors.

Sources of finance on the Kingdom's project financings have varied based on the nature and scope of each particular project and the parties involved – although they have generally been drawn from a mixture of domestic, regional and international banks (both conventional and Islamic) and export credit agencies. For the next wave of mining and minerals and energy transition projects in the Kingdom, sponsors are likely to look to a similar pool of financiers. There is also the possibility of tapping the bond and sukuk markets, although this is a more challenging option for greenfield projects and we anticipate this would more likely be a refinancing option during the operational phase of a project.

As noted above, the New Mining Law provides for the establishment of a fund to support the financing of mining projects, and the government's Saudi Industrial Development Fund (SIDF) has a mandate to provide financing to the mining and minerals sector. In 2021, SIDF reported that it had made available loans worth more than US\$4.5bn for companies in the industry, mining, energy and logistic services sectors.⁶



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Closing note

While investor focus has to a large extent concentrated on the Kingdom's oil and gas, petrochemicals, power and water sectors, and more recently on the Vision 2030 mega-projects, the Kingdom's mining and minerals and energy transition sectors present a tremendous opportunity for investors, developers, financiers and other market participants. The clear commitment by the Kingdom's leadership to enhance the mining and minerals and energy transition sectors and to facilitate and support the participation of local, regional and international private-sector investors, sends a robust signal to the markets that these industries are considered key components of the Kingdom's planned economic and industrial transformation under the Vision 2030 plan.

In the coming years, as critical and rare earth markets develop, bankable project structures will develop as investors and financiers gain comfort with project-specific risks. As a result, available sources of financing will expand for such projects. Individual projects will inevitably have unique inherent risks, but many issues will be structural and recurring and solutions that have worked in the past are likely to work again in the future. Where new risks arise, investors can take comfort that sponsors, developers, financiers and their

respective advisors have an impressive track record of working together to find constructive solutions to develop and finance world-leading industrial projects in the Kingdom. ■

Footnotes

- 1 - Such as NEOM, Qiddiya and the Red Sea Project. For further details, refer to: <https://www.neom.com/en-us/about>; <https://qiddiya.com/>; <https://www.theredsea.sa/en>
- 2 - For further details, refer to: <https://sgs.org.sa/en/geology-of-saudi-arabia/>
- 3 - For further details, refer to: <https://www.vision2030.gov.sa/v2030/vrps/nidlp/>
- 4 - For further details, refer to: <https://www.evmetalsgroup.com/>
- 5 - Further steps are being taken in respect of logistics with the development of industrial cities such as the King Salman Energy Park (SPARK) which consists of, among other things, a dry port and logistics zone with an expected annual capacity of 8 million tons of cargo. While SPARK is mainly being developed to support the energy sector, it is nonetheless a significant step towards developing the utilities and logistics infrastructure in the Kingdom to support many industries, including the mining industry. For further details, refer to: <https://www.spark.sa/>
- 6 - For further details, refer to: <https://www.sidf.gov.sa/en/ServicesforInvestors/Sectors/Pages/mining.aspx>



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